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No. 90-673

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1990

FRANCIS EDWIN BASS, JR., *et al.*,
*Petitioners,*
v.
STATE OF SOUTH CAROLINA, *et al.*,
*Respondents.*

**On Petition for a Writ of Certiorari to the Supreme Court of South Carolina**

## MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* ON BEHALF OF THE WISCONSIN STATE FEDERATION OF CHAPTERS OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES IN SUPPORT OF PETITIONERS

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Pursuant to Rule 37.2 of the Rules of this Court, *amicus* respectfully moves for leave to file the attached brief *amicus curiae* in support of the Petitioners. Petitioners have consented to the filing of the brief. The consent of the Respondents was requested but refused.

### INTEREST OF *AMICUS*

*Amicus* is the Wisconsin State Federation of Chapters of the National Association of Retired Federal Employees ("NARFE"). NARFE is a nonprofit, incorporated association having its principal place of business in Washington, D.C. From its original fourteen charter members, NARFE has grown to a membership now ex-

ceeding half a million federal annuitants (retirees and survivors) living throughout the fifty states, Puerto Rico, and the Canal Zone, the Republic of the Philippines, and various foreign countries. NARFE has been a major advocate in maintaining the integrity of the federal government's civilian retirement systems and has been directly involved, through lobbying and related activities, in all legislative and executive changes in these systems over the past six decades.

NARFE has concerned itself with issues affecting the aged and aging, and in particular those issues that affect federal annuitants. NARFE's goal is to identify issues of particular importance to federal annuitants, to inform them, through its Newsletter and the state and local chapter network, of these issues, and to act upon these issues to further the members' common goals. NARFE also assists federal annuitants in obtaining benefits to which they may be entitled under the retirement laws by interacting with various federal agencies and private entities on such matters as federal annuities and health and life insurance benefits. The Wisconsin State Federation of Chapters is involved with implementing NARFE's policies in the State of Wisconsin and coordinating local activities.

The State of South Carolina and at least twenty-two other states taxed the federal retirement benefits of federal annuitants while exempting from state taxation the retirement benefits of state annuitants. This disparate tax treatment is in violation of 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity.

The question presented in this case—whether the refunds of state income tax imposed in violation of 4 U.S.C. § 111 may be denied through a prospective-only application of *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 109 S. Ct. 1500 (1989)—is vitally important to *amicus*. If a prospective-only application of *Davis* is ap-

plied, these federal annuitants will suffer economic harm. Thus, *amicus* has a compelling and vital interest in the proper resolution of the question presented. Accordingly, *amicus* respectfuly moves for leave to file the attached brief *amicus curiae* in support of the Petitioners.

Respectfully submitted,


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## QUESTION PRESENTED

Whether the refunds of state income tax imposed in violation of 4 U.S.C. § 111 may be denied through a prospective application of *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 109 S. Ct. 1500 (1989)?

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### INTEREST OF THE *AMICUS CURIAE*

The interest of the *amicus* is set forth in the motion accompanying this brief.

### STATEMENT

This case raises important questions regarding the propriety of states retaining taxes imposed and collected from its citizens in violation of the Constitution of the United States and 4 U.S.C. § 111. It involves whether state courts have the authority to decree that a decision of this Court striking down state taxes on constitutional grounds may be applied prospectively only. In particular, this case involves whether this Court's decision in

*Davis v. Michigan Department of Treasury*, 489 U.S. 803, 109 S. Ct. 1500 (1989), may be applied in a prospective only fashion so as to deny tax refunds to federal retirees.

In *Davis*, this Court held that 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity prohibited the State of Michigan from taxing federal retirees more harshly than state retirees. Like Michigan, the State of South Carolina, and approximately 20 other states, exempted state annuities of retired state and local employees from state income taxation while taxing the annuities of retired federal employees.

In the wake of *Davis*, the petitioners submitted amended state income tax returns for tax years 1985 through 1988 seeking refunds of all taxes paid on that portion of their income consisting of federal retirement income as a result of South Carolina's discriminatory taxing scheme. The South Carolina Tax Commission denied all *Davis*-related refund claims.

Petitioners filed suit in Horry County Court of Common Pleas seeking refunds for taxes collected in violation of 4 U.S.C. § 111 and the constitutional doctrine of intergovernmetnal tax immunity. On June 8, 1989, the South Carolina legislature enacted legislation, effective immediately, which purported to divest petitioners of their right under state refund laws to obtain refunds. S.C.Stat.Ann. § 12-47-445.

The trial court ruled in favor of the petitioners, holding that they were entitled to refunds pursuant to South Carolina statutory and decisional law. The trial court also found that the new state law which purported to divest petitioners of their refund right had no effect on the refunds sought by the petitioners since the taxes in question all predated the newly enacted legislation.

The State appealed the trial court's decision. The Supreme Court of South Carolina reversed the trial court's

decision, finding that the *Davis* decision applied prospectively only. On petitioners' petition for rehearing, and subsequent to this Court's decisions in *McKesson v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990) and *American Trucking Ass'n v. Smith*, 110 S. Ct. 2323 (1990), the court amended its prior decision, suggesting that petitioners had not satisfied state tax refund requirements because the taxes paid by the federal annuitants were not paid "under protest". Despite this reference to state law, the court expressly noted that its decision was based on its finding that *Davis* should not be applied retrospectively and, therefore, no analysis of state law was required. In any event, the issue of whether the petitioners were required to file under protest had not been argued, briefed or decided at the trial court and had not been properly raised on appeal pursuant to South Carolina appellate practice. Thus, no state law ground independently supports the decision below.

## SUMMARY OF THE ARGUMENT

*Amicus* asks that this Court grant certiorari to reverse the decision of the Supreme Court of South Carolina. In the decision below, the court, motivated by uniquely parochial interests, substituted its judgment for that of Congress. The decision is irreconcilable with this Court's decisions in *McCulloch v. Maryland*, 4 Wheat. 316 (1819) and *Claflin v. Houseman*, 93 U.S. 130 (1876). A state court simply does not have the power under the guise of the prospectivity doctrine to change the effective date of a congressional enactment.

In the decision below, the Supreme Court of South Carolina relied on its view of the prospectivity doctrine. Assuming that this Court is persuaded that it should apply the plurality test of *American Trucking Ass'n v. Smith*, 110 S. Ct. 2323 (1990), and assuming further that the threshold test for prospectivity is somehow deemed satisfied, this Court should determine the appro-

priate parameters of inquiry necessary to sustain a determination of prospectivity under prongs two and three. The court below summarily concluded that because the offending statute had been repealed prospectively, the second prong had been satisfied. With respect to the third prong, the court's consideration addressed only the fiscal impact to the State. In contrast to the summary consideration of the court, a meaningful inquiry under prongs two and three would have established that a failure to apply *Davis* retroactively, in fact, frustrates the operation of the rule. This Court should take the opportunity to frame the duty of a court to engage in a meaningful inquiry under prongs two and three of the prospectivity test. This is particularly so in a case where the interests of the United States and individuals are at issue. It is believed that a proper analysis requires the consideration of factors both different in degree and kind than those previously considered in the context of the dormant Commerce Clause.

In *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990), this Court observed that when a tax is "beyond the State's power to impose" then the State has "no choice but to 'undo' the unlawful deprivation by refunding the tax . . . ." *Id.* at 2251. Prior decisions of this Court indicate that discriminatory state tax schemes which violate the doctrine of intergovernmental immunity are beyond a State's power to impose. *See Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 370 (1960); *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744 (1961). In a case such as this, a retroactive imposition of a higher state tax on state retirees would not undo the injury to the federal fisc. *Amicus* respectfully requests that this Court address the remedial issues in a case such as this and hold that the discrimination may only be undone by a refund of the unlawful tax.

In view of the fact that this case has produced a conflict between the highest courts of at least two states and

in view of the risk that the decision, if allowed to stand, will be followed in other states, review by this Court is necessary to resolve this conflict which involves a fundamental issue of federalism.[1] If there be any doubt as to the need for certiorari, *amicus* requests that the Court seek the views of the Solicitor General of the United States because of the important federal interest implicated in the decision below.

## ARGUMENT

### I. A STATE COURT DOES NOT HAVE THE POWER TO CHANGE THE EFFECTIVE DATE OF A CONGRESSIONAL ENACTMENT

In *Davis v. Michigan Department of the Treasury*, 489 U.S. 803, 109 S. Ct. 1500 (1989), this Court construed the "plain language" of 4 U.S.C. § 111 and concluded that the "statute leaves no room for doubt" that federal retirement benefits "are subject to § 111." *Id.*, 109 S. Ct. at 1504. However, in the decision below, the Supreme Court of South Carolina, motivated solely by parochial concerns and ostensibly relying on its views of the prospectivity doctrine, apparently believed that it had the unfettered power to change the effective date of this unambiguous federal statute. The practical consequence of its decision, if permitted to stand, is that 4 U.S.C. § 111 is effective for all tax years after *1988* in South Carolina, whereas the statute has been effective throughout the

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[1] Prior to the filing of this petition, Attorneys General of several states, in an unprecedented, concerted effort over the course of last term and this term, have attempted to preordain the outcome of this case by repeatedly addressing this issue, inappropriately, in the context of the Commerce Clause. *See, e.g.*, Amicus Curiae Brief of the States of Virginia, Alabama, Arizona, Arkansas, Colorado, Indiana, Iowa, Louisiana, Maine, Maryland, Minnesota, New Jersey, New York, Utah, Vermont and Wisconsin filed in *James B. Beam Distilling Co. v. Georgia*, U.S. No. 89-680. Given this extraordinary effort, they should not be heard to complain that this Court will take the case now that it is properly before the Court.

rest of the country since January 1, 1939. *See* Public Salary Tax Act of 1939, Ch. 59, § 4. (App. A at 1a).

Within the last two weeks, a trial court in the state of Oregon has been persuaded to ignore clearly established state refund statutes and long-standing administrative refund practices and has ruled, in reliance upon the decision below, that for years prior to 1989 the discriminatory scheme was not "unconstitutional." *See Ragsdale v. Department of Revenue*, No. 2958 (Oregon Tax Court, Nov. 7, 1990). In addition, in virtually all of the states where *Davis* related litigation is not yet final, trial and appellate courts are being urged to adopt the decision below as dispositive constitutional law.[2]

The position urged by the defendants below and adopted by the Supreme Court of South Carolina is unprecedented. In fact, it is fundamentally inconsistent with settled notions of federalism and state courts' obligations under the Supremacy Clause. Moreover, given the hysteria created by the exaggerated claims of the fiscal burden advanced by the Attorneys General of several states, there is a real risk that the jurisprudence of several states will be infected by the adoption of this decision.

The decision below is irreconcilable with this Court's landmark decision of *McCulloch v. Maryland*, 4 Wheat. 316 (1819). The Supreme Court of South Carolina, no matter how honorable its motives, did not have the "power" to substitute its determination for that of Congress:

> [T]he States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry into execution the powers vested in the general government.

*Id.* at 436.

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[2] *See, e.g.*, State defendants' brief in *Hogan v. Musolf*, —— Wis. 2d ——, 459 N.W.2d 865 (Ct. App. 1990), *appeal docketed*, No. 89-1175 (Sept. 18, 1990).

As recently as last term, a unanimous Court reaffirmed this principle in the context of 42 U.S.C. § 1983, noting that:

> The policy of the Federal Act was to be considered "the prevailing policy in every state" which the state court could not refuse to enforce " 'because of conceptions of impolicy or want of wisdom on the part of Congress in having called into play its lawful powers.' "

*Howlett v. Rose*, 110 S. Ct. 2430, 2442 (1990) (citations omitted).

Indeed, if the decision below were to stand, the resulting anomaly in the law would be breathtaking. In *Fleming v. Fleming*, 264 U.S. 29 (1924), this Court ruled with respect to a state court's construction of a state statute that:

> The effect of the subsequent decisions is not to make a new law but only to hold that the law always meant what the court now says it means. The court has power to construe a legislative act, but it has no power by change in construction to date its passage as a law from the time of the latter decisions.

*Id.* at 31-32. Under this settled view, the Supreme Court of South Carolina would be powerless to change the effective dates of legislation of its own legislature, but yet, motivated by uniquely parochial interests, would have the power, within South Carolina, to change the effective dates of legislation passed by Congress. However, as this Court has repeatedly ruled:

> The laws of the United States are laws in the several States, and just as much binding on the citizens and courts thereof as the State laws are.

*Claflin v. Houseman*, 93 U.S. 130, 136 (1876).

In a context perfectly analogous to the issues presented here, this Court has previously noted that it does not

possess the power which the Supreme Court of South Carolina exercised below. In *Aloha Airlines, Inc. v. Director of Taxation*, 464 U.S. 7 (1983), this Court invalidated a Hawaii statute that imposed a tax on gross income of airlines operating within the State because it had been pre-empted by Congress.[3] In so holding, this Court noted that it was bound by the determination of Congress:

> We acknowledge that our interpretation of § 1513(a) may result in the disruption of state systems of taxation; we are, however *bound* by the plain language of the statute.

*Id.* at 14 n.10 (emphasis added).[4]

*Amicus* respectfully submits that the important issue of federalism decided by the court below presents a significant danger, the impact of which transcends the interests of federal retirees of South Carolina and the hundreds of thousands of federal retirees whose rights under *Davis* are currently the subject of ongoing litigation in approximately 19 states. The reaction of the states to the carefully articulated retroactivity decisions of last

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[3] Prior pronouncements of this Court in the context of legislation involving a Congressional waiver of intergovernmental tax immunity indicate that, absent a religious adherence to the requirements of such legislation, state tax enactments will be invalidated. *See, e.g., Chase Manhattan Bank v. Finance Administration*, 440 U.S. 447 (1979).

[4] *See also Commissioner of Immigration v. Gottlieb*, 265 U.S. 310, 312 (1924) ("The case, as the evidence shows, is one of peculiar and distressing hardship, and it is not unnatural that any appropriate canon of construction should be laid hold of to justify a conclusion favorable to respondents. But if the plain words of the statute are against such a conclusion, leaving no room for construction, the courts have no choice but to follow it, without regard to the consequences."); *Railroad Retirement Board v. Alton R. Co.*, 295 U.S. 330, 346 (1935) ("Our duty, like that of the court below, is fairly to construe the powers of Congress, and to ascertain whether or not the enactment falls within them, uninfluenced by prediction for or against the policy disclosed in the legislation.").

term, albeit divergent, has not been to recognize that prospectivity is the carefully limited exception, but instead has been to urge that these decisions provide an unqualified license which allows a state court to avoid any obligation, based solely on an untested (and perhaps inflated) estimate of the cost of compliance. The real danger that this case presents is that it will be readily extended by South Carolina and other states to limit states' obligations to comply with Congressional enactments involving the general welfare. Consistent with the command of the Supremacy Clause and *McCulloch v. Maryland*, *supra*, a grant of the petition for writ of certiorari in this case will permit this Court to resolve the uncertainty created in the law of the several states as the result of the decision below.

## II. ASSUMING THIS COURT DETERMINES THAT THE PLURALITY APPROACH OF *AMERICAN TRUCKING ASS'N* MAY BE APPLIED IN DETERMINING THE EFFECTIVE DATE OF A CONGRESSIONAL ENACTMENT, A DETERMINATION OF PROSPECTIVITY MAY ONLY BE UPHELD UPON A MEANINGFUL ANALYSIS OF THE SECOND AND THIRD PRONGS OF *CHEVRON*

The plurality observed in *American Trucking Ass'n v. Smith*, 110 S. Ct. 2323 (1990), that the "policy concerns involved" in a decision delineating the scope of liability under a federal statute "are quite distinct" and provide little guidance for determining the fairest way to apply the Court's decisions in the context of the dormant Commerce Clause doctrine. *Amicus* respectfully submits that the application of the prospectivity test reflected in the plurality decision of *American Trucking Ass'n* is particularly inappropriate to a case such as this where Congress has made the express policy decision as to the statute's effective date. However, assuming this Court is persuaded that it should apply the *American Trucking Ass'n* plurality test, and assuming further that the thres-

hold test is somehow deemed satisfied, this Court should determine the appropriate parameters for prongs two and three of that test when applied in the context of a state personal income tax where the interests of the United States, as well as elderly citizens, are implicated.[5]

Setting aside the issue of whether the first prong was correctly determined, the court below summarily concluded that, because the statute at issue was repealed prospectively, this prong had been satisfied. (Pet. App. 7a). This summary observation can hardly be deemed adequate.

This Court should take the opportunity to frame the duty of a court to engage in a meaningful inquiry under this prong. Had such an inquiry been undertaken in this case, the court below would have been forced to conclude that the purpose of the rule could be furthered only by retrospective operation. The court's failure to apply *Davis* retroactively, in fact, frustrates the operation of the rule.

For forty-three years, South Carolina reduced its employment costs at the expense of the federal treasury. *See Davis*, 109 S. Ct. at 1507-08 n.4. In addition, during that same period of time, it misappropriated substantial

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[5] As cogently pointed out in the petition in this case, the determination of the Supreme Court of South Carolina on the first prong appears to be nothing more than a bald conclusion. A review of this Court's opinion in *Davis v. Michigan* indicates quite clearly that the party who sought to overrule "clear past precedent" was not the taxpayer but the Michigan Department of the Treasury. *Davis*, 109 S. Ct. at 1507. In addition, under this Court's reasoning in *Ashland Oil Co. v. Caryl*, 110 S. Ct. 3202 (1990) and *National Mines Corp. v. Caryl*, 110 S. Ct. 3205 (1990), it also appears that even if *Davis* is subject to the prospectivity test, it still should be applied retroactively. *See South Carolina v. Baker*, 485 U.S. 505, 520 n.10 (1988) (The law has always been that Congress has the power to enact statutes immunizing those with whom it deals from state taxation even if the doctrine would not otherwise confer immunity.).

federal revenues by virtue of the discriminatory tax imposed upon federal retirees. These state exactions were deducted by numerous federal retirees under 26 U.S.C. § 164, directly reducing federal income tax collections for each of those years. (App. B at 6a). Refunds of these taxes now will enable the federal government to recover part of the federal revenues misappropriated by South Carolina in past years. Under the Tax Benefit Doctrine and section 111 of the Internal Revenue Code, any refund ordered will be subject to federal tax in the year received. *Id.* Consequently, the refusal of the Supreme Court of South Carolina to order refunds has actually resulted in a new violation of 4 U.S.C. § 111.

With respect to the third prong, the court's analysis is almost nonexistent. (*See* Pet. App. 8a). Its analysis consisted solely of the alleged financial burden upon the state. The relevant equities are far broader in this case and generally, in the context of a personal income tax case, should differ significantly from those weighed under a Commerce Clause challenge.

First, the court below made no effort to quantify the windfall that South Carolina received during the forty-three years this unlawful scheme was in effect.[6] Common sense suggests that the amount of taxes exacted for years before 1985 exceeds by several times any present refund obligation. Second, South Carolina did not hesitate to accept that part of the Public Salary Tax Act of 1939 which benefitted its parochial interests. Under Title II of the Act, South Carolina's retirees, as well as its then current employees, enjoyed total immunity from the fed-

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[6] Indeed, it is surprising that the state of South Carolina even urged that the equities favored no relief. For its size and contribution to the federal fisc, South Carolina's economy for years has been the beneficiary of a generous federal government. Recent statistical data reflect that in fiscal year 1989, the Department of Defense, alone, spent almost $3.2 billion in the state. *See* Department of Defense ATLAS/DATA ABSTRACT FOR THE UNITED STATES AND SELECTED AREAS—FY 1989. (App. C at 9a).

eral income tax for all years prior to 1939. *See* Public Salary Tax Act of 1939, Ch. 59, Title II. (App. A at 2a). Having accepted the benefits of the Act, equity compels that South Carolina now accept its burden.

Most significantly, the court failed to analyze the equities and reliance interests of its federal retirees, many of whom are elderly. Unlike *American Trucking Ass'n* and *McKesson*, the taxpayers here are not sophisticated multi-state business enterprises. They are average, law-abiding citizens who complied with the mandates of the South Carolina law in reliance on their assumption that the State of South Carolina is an honorable government. For purposes of weighing the equities, they should not now be penalized by South Carolina for complying with its laws. Moreover, it is totally inappropriate for a court to penalize an elderly citizen because the citizen could not afford to challenge that which the State should have known was, at best, suspect.[7] Moreover, with respect to South Carolina's tax collections after this Court's announcement of *Davis*, the record establishes that there

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[7] As noted in the now final decision of Judge Hererra in the *Davis*-related case of *Burns v. Shaw*, No. 89-1314(c) (Santa Fe County, N.M., Apr. 5, 1990):

> [T]he State . . . argues that the decision in *Davis* was not foreshadowed because it has gone unchallenged. Such an analysis begs the question. The State . . . cannot sit by and wait until a law is challenged without an independent analysis of whether or not it is legal. What rationale did the State have for treating Federal retirees and State retirees differently? . . . The operative question should not be whether the statutory scheme was challenged, relying on actions by some unidentified parties, but whether it was reasonable for the State . . . to assume that it was constitutionly [sic] permissible to treat State retirees differently from Federal retirees. Such a distinction defies logic and could have been anticipated by the State . . . even without intervention from the United States Supreme Court. An *objective* analysis would have led the State . . . to conclude that the distinction was suspect and incorrect.

*Id.*, slip op. at 4 (emphasis added).

are no equities which would justify the retention of these taxes. (Pet. App. 30a-35a).

The Supreme Court of South Carolina's analysis of the equities also manifests a lack of understanding of the uniqueness of the personal income tax. Most states have long since adopted the federal standard of equity and conscience which favors the taxpayer.[8] This standard has its genesis in several of this Court's decisions involving federal taxation. As noted in *Moore Ice Crean Co. v. Rose*, 289 U.S. 373 (1933), "[a] high-minded government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience." *Id.* at 379. This standard expressly rejects such "ignoble" concepts as payment under protest, the power of the sovereign to retain invalid exactions, and the power to qualify the refund right by prospective decisions. Moreover, the federal refund right is conditioned or limited *solely* by the statute of limitations. In *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947), this Court said:

> [W]e read the word 'overpayment' in its usual sense, as meaning any payment in excess of that which is properly due. Such an excess payment may be traced to an error in mathematics or in judgment or in interpretation of facts or law. And the error may be committed by the taxpayer or by the revenue agents. Whatever the reason, the payment of more than is rightfully due is what characterizes an overpayment.

*Id.* at 531. This standard is based on sound considerations of public policy and seeks as its end to promote compliance with the income tax system.[9]

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[8] *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989) (banc), *cert. denied*, 110 S. Ct. 718 (1990); New York Tax Law, §§ 687(a) and 607(a) (McKinney's 1986 & Supp. 1990) (App. D at 10a).

[9] *See* REPORT AND RECOMMENDATIONS ON TAXPAYER COMPLIANCE, American Bar Association Commission on Taxpayer Compliance, July, 1989, 41 Tax Lawyer 329, 353 (1988) ("Strict and unreason-

Refunds in cases such as this one would actually be in the best interest of the state because they would restore taxpayer confidence in the integrity and fairness of the personal income tax of South Carolina and the courts which are called upon to cure the abuses of those who are entrusted to enforce it. It is now a matter of common knowledge that honest citizens have less confidence in the fairness of the system and have been subject to widespread abuse by state tax collectors. This problem has become so significant that the organized bar has called for immediate reform by each of the states in light of its findings that:

> For many years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. When taxpayers perceive such treatment, voluntary compliance is seriously threatened. Addressing these concerns should increase respect for the tax system and improve the level of voluntary compliance.

Section of Taxation REPORT TO HOUSE OF DELEGATES, August, 1990 at 2. (App. E at 12a.) If South Carolina is permitted to breach its obligation to its citizens to pay refunds, all citizens of South Carolina will ultimately pay a higher price as the result of increasing noncompliance.

This Court should take the opportunity in this case to frame the scope of the inquiry necessary to sustain a finding of prospective application only. At a minimum, such an inquiry should require an affirmative showing of the taxing authority that, under its settled practice in the context of the particular tax involved, its conduct in denying a refund has been manifestly reasonable.

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able enforcement can, in fact, contribute to undermining the policy goals which the rules are designed to enforce.").

## III. A RETROACTIVE REFUND IS THE ONLY APPROPRIATE REMEDY FOR A DISCRIMINATORY STATE TAX WHICH VIOLATES A FEDERAL STATUTE INCORPORATING THE INTERGOVERNMENTAL IMMUNITY DOCTRINE

In *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990), this Court observed that when a tax is "beyond the State's power to impose" then the state has "no choice but to 'undo' the unlawful deprivation by refunding the tax . . . ." *Id.* at 2251. In contrast to the apparent distinction noted in *McKesson* with respect to discriminatory taxes under the Commerce Clause, prior decisions of this Court indicate that discriminatory state tax schemes which violate the doctrine of intergovernmental immunity are beyond a state's power to impose. In *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 370 (1960), this Court held that such taxes "may not be exacted." *Id.* at 387. In *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744 (1961), this Court held that the tax was "void." *Id.* at 752.

This Court has not yet had the opportunity to address the remedial issues in a case such as this, where the tax violates the intergovernmental tax immunity doctrine and 4 U.S.C. § 111. As noted above, a retroactive imposition of a higher state tax on state retirees would not undo the injury to the federal fisc. In fact, it would compound the injury of the United States by decreasing future federal tax collections as the result of increased itemized deductions for the retroactive state tax. *See* 26 U.S.C. § 164. (App. B at 6a.) This, in turn, would provide the state with a second windfall for having violated 4 U.S.C. § 111. *See Davis*, 109 S. Ct. at 1507 n.4. *Amicus* respectfully requests that this Court resolve this remedial issue in this case and hold that the discrimination may only be undone by a refund of the unlawful tax.

## CONCLUSION

The decision below appears to use a strained, if not, an incorrect prospectivity analysis as a pretext to disguise the court's conscious disregard for settled constitutional rights. *Amicus* respectfully submits that the petition for a writ of certiorari to the Supreme Court of South Carolina should be granted.

Respectfully submitted,

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# APPENDICES

## APPENDIX A

## PUBLIC SALARY TAX ACT OF 1939

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### AN ACT

Relating to the taxation of the compensation of public officers and employees.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Public Salary Tax Act of 1939".

### TITLE I

SECTION 1. Section 22 (a) of the Internal Revenue Code (relating to the definition of "gross income") is amended by inserting after the words "compensation for personal service" the following: ("including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing)".

SEC. 2. Section 116 (b) of the Internal Revenue Code (exempting compensation of teachers in Alaska and Hawaii from income tax) is repealed.

SEC. 3. Section 22 (a) of the Internal Revenue Code is amended by adding at the end thereof a new sentence to read as follows: "In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income".

SEC. 4. The United States hereby consents to the taxation of compensation, received after December 31, 1938, for personal service as an officer or employee of the United States, any Territory or possession of political subdivision thereof, the District of Columbia, or any agency or instrumentality of any one or more of the foregoing, by any duly constituted taxing authority having jurisdiction

to tax such compensation, if such taxation does not discriminate against such officer or employee because of the source of such compensation.

## TITLE II

SEC. 201. Any amount of income tax (including interest, additions-to-tax, and additional amounts) for any taxable year beginning prior to January 1, 1938, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing—

(a) shall not be assessed, and no proceeding in court for the collection thereof shall be begun or prosecuted (unless pursuant to an essessment made prior to January 1, 1939);

(b) if assessed after December 31, 1938, the assessment shall be abated, and any amount collected in pursuance of such assessment shall be credited or refunded in the same manner as in the case of an income tax erroneously collected; and

(c) shall, if collected on or before the date of the enactment of this Act, be credited or refunded in the same manner as in the case of an income tax erroneously collected, in the following cases—

(1) Where a claim for refund of such amount was filed before January 19, 1939, and was not disallowed on or before the date of the enactment of this Act;

(2) Where such claim was so filed but has been disallowed and the time for beginning suit with respect thereto has not expired on the date of the enactment of this Act;

(3) Where a suit for the recovery of such amount is pending on the date of the enactment of this Act; and

(4) Where a petition to the Board of Tax Appeals has been filed with respect to such amount and the Board's decision has not become final before the date of the enactment of this Act.

SEC. 202. In the case of any taxable year beginning after December 31, 1937, and before January 1, 1939, compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall not be included in the gross income of any individual under Title I of the Revenue Act of 1938 and shall be exempt from taxation under such title, if such individual either—

(a) did not include in his return for a taxable year beginning after December 31, 1936, and before January 1, 1938, any amount as compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing; or

(b) did include any such amount in such return, but is entitled under section 201 of this Act to have the tax attributable thereto credited or refunded.

SEC. 203. Any amount of income tax (including interest, additions to tax, and additional amounts) collected on, before, or after the date of the enactment of this Act for any taxable year beginning prior to January 1, 1939, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall be credited or refunded in the same manner as in the case of an income tax erroneously collected, if claim for refund with respect thereto is filed after January 18, 1939, and the Commissioner of Internal Revenue, under regulations prescribed by him with the approval of the Secretary of the Treasury, finds that disallowance of

such claim would result in the application of the doctrines in the cases of Helvering against Therrell (303 U.S. 218), Helvering against Gerhardt (304 U. S. 405), and Graves et al. against New York ex rel O'Keefe, decided March 27, 1939, extending the classes of officers and employees subject to Federal taxation.

SEC. 204. Neither section 201 nor section 203 shall apply in any case where the claim for refund, or the institution of the suit, or the filing of the petition with the Board, was, at the time filed or begun, barred by the statute of limitations properly applicable thereto.

SEC. 205. Compensation shall not be considered as compensation within the meaning of sections 201, 202, and 203 to the extent that it is paid directly or indirectly by the United States or any agency or instrumentality thereof.

SEC. 206. The terms used in this Act shall have the same meaning as when used in Chapter 1 of the Internal Revenue Code.

SEC. 207. No collection of any tax (including interest, additions to tax, and penalties) imposed by any State, Territory, possession, or local taxing authority on the compensation, received before January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof which is exempt from Federal income taxation and, if a corporate agency or instrumentality, is one (a) a majority of the stock of which is owned by or on behalf of the United States, or (b) the power to appoint or select a majority of the board of directors of which is exercisable by or on behalf of the United States, shall be made after the date of the enactment of this Act.

SEC. 208. This title shall not apply with respect to any officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, after the Secretary of the Treas-

ury has determined and proclaimed that it is the policy of such State to collect from any individual any tax, interest, additions to tax, or penalties, on account of compensation received by such individual prior to January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof. In making such determination the Secretary of the Treasury shall disregard the taxation of officers and employees of any corporate agency or instrumentality which is not exempt from Federal income taxation, or which if so exempt is one (a) a majority of the stock of which is not owned by or on behalf of the United States and (b) the power to appoint or select a majority of the board of directors of which is not exercisable by or on behalf of the United States.

SEC. 209. In the case of the judges of the Supreme Court, and of the inferior courts of the United States created under article III of the Constitution, who took office on or before June 6, 1932, the compensation received as such shall not be subject to income tax under the Revenue Act of 1938 or any prior revenue Act.

SEC. 210. For the purposes of this Act, the term "officer or employee" includes a member of a legislative body and a judge or officer of a court.

SEC. 211. If either title of this Act, or the application thereof to any person or circumstances, is held invalid, the other title of the Act shall not be affected thereby.

Approved, April 12, 1939.

## APPENDIX B

### EXCERPTS FROM THE INTERNAL REVENUE CODE

[Sec. 111]

SEC. 111. RECOVERY OF TAX BENEFIT ITEMS.

[Sec. 111(a)]

(a) DEDUCTIONS.—Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter.

[Sec. 164]

SEC. 164. TAXES.

[Sec. 164(a)]

(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) The GST tax imposed on income distributions.

(5) The environmental tax imposed by section 59A.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for

production of income). Notwithstanding the preceding sentence, any tax (not described in the first sentence of this subsection) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.

## APPENDIX C

## EXCERPT FROM DOD ATLAS—FY 1989

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### DoD ESTIMATED PAYROLL AND PRIME CONTRACTS BY STATE

(THOUSANDS OF DOLLARS)
FISCAL YEAR 1989

| State | Civilian Pay | Military Active Duty Pay | Reserve & National Guard Pay | Retired Military Pay | Total Compensation | Civil Functions Contracts | Military Functions Contracts | Total Contracts |
|---|---|---|---|---|---|---|---|---|
| Alabama | 789,524 | 588,907 | 222,248 | 498,323 | 2,099,002 | 86,857 | 1,305,531 | 1,392,388 |
| Alaska | 193,392 | 567,974 | 24,774 | 64,562 | 850,702 | 17,458 | 522,337 | 539,795 |
| Arizona | 304,621 | 589,779 | 71,806 | 527,678 | 1,493,684 | 11,368 | 2,835,519 | 2,846,887 |
| Arkansas | 136,907 | 199,024 | 71,951 | 255,818 | 663,700 | 38,261 | 331,331 | 369,592 |
| California | 4,012,634 | 6,516,801 | 431,083 | 2,952,123 | 13,912,641 | 60,595 | 23,064,102 | 23,124,697 |
| Colorado | 363,176 | 1,008,837 | 114,248 | 563,590 | 2,039,851 | 6,899 | 2,921,402 | 2,928,301 |
| Connecticut | 164,690 | 287,806 | 49,112 | 135,908 | 637,516 | 1,269 | 6,081,021 | 6,082,290 |
| Delaware | 47,157 | 96,153 | 27,281 | 64,451 | 235,042 | 12,283 | 158,753 | 171,036 |
| District of Columbia | 564,469 | 386,633 | 98,044 | 66,730 | 1,115,876 | 6,652 | 1,229,312 | 1,235,964 |
| Florida | 1,030,474 | 2,215,970 | 153,749 | 2,092,292 | 5,492,485 | 28,356 | 4,424,027 | 4,452,383 |
| Georgia | 1,030,707 | 1,731,308 | 271,133 | 740,461 | 3,773,609 | 34,357 | 1,829,823 | 1,864,180 |
| Hawaii | 639,481 | 1,362,357 | 40,274 | 191,892 | 2,234,004 | 8,018 | 570,715 | 578,733 |
| Idaho | 34,934 | 112,486 | 39,122 | 98,955 | 285,497 | 667 | 74,122 | 74,789 |
| Illinois | 560,533 | 729,495 | 166,545 | 308,140 | 1,764,713 | 30,814 | 1,218,287 | 1,249,101 |
| Indiana | 456,254 | 141,030 | 184,216 | 185,080 | 966,580 | 9,714 | 1,753,363 | 1,763,077 |
| Iowa | 37,837 | 9,297 | 57,692 | 81,894 | 186,720 | 7,897 | 418,013 | 452,910 |
| Kansas | 180,175 | 623,131 | 188,094 | 192,962 | 1,162,362 | 6,754 | 948,213 | 954,967 |
| Kentucky | 350,445 | 1,093,166 | 102,836 | 210,812 | 1,757,259 | 23,573 | 309,151 | 332,724 |
| Louisiana | 237,848 | 686,722 | 111,654 | 307,564 | 1,343,788 | 221,848 | 1,471,639 | 1,693,487 |
| Maine | 307,916 | 182,335 | 31,304 | 118,118 | 639,673 | 385 | 369,626 | 370,011 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Maryland | 1,378,780 | 898,527 | 142,181 | 537,183 | 2,956,671 | 26,381 | 3,844,497 | 3,870,878 |
| Massachusetts | 367,011 | 283,266 | 145,629 | 244,936 | 1,040,842 | 13,459 | 8,744,008 | 8,757,467 |
| Michigan | 367,889 | 188,637 | 114,947 | 213,904 | 885,377 | 10,215 | 1,255,716 | 1,265,931 |
| Minnesota | 87,736 | 21,762 | 94,021 | 126,551 | 330,070 | 12,787 | 1,761,187 | 1,773,974 |
| Mississippi | 312,429 | 379,785 | 89,776 | 234,067 | 1,016,057 | 73,868 | 1,160,690 | 1,234,558 |
| Missouri | 630,224 | 422,642 | 187,227 | 317,805 | 1,557,989 | 42,655 | 6,239,994 | 6,282,549 |
| Montana | 37,566 | 93,064 | 26,769 | 59,910 | 217,309 | 2,461 | 78,075 | 80,536 |
| Nebraska | 113,564 | 343,581 | 37,941 | 125,349 | 620,435 | 4,663 | 217,021 | 221,684 |
| Nevada | 54,035 | 226,732 | 19,641 | 226,554 | 526,962 | 36 | 230,112 | 230,148 |
| New Hampshire | 45,718 | 99,595 | 21,008 | 114,726 | 281,047 | 6,722 | 471,076 | 477,798 |
| New Jersey | 711,011 | 493,703 | 145,965 | 279,003 | 1,629,682 | 108,900 | 3,284,471 | 3,393,371 |
| New Mexico | 290,290 | 349,384 | 49,515 | 261,623 | 950,812 | 9,356 | 615,676 | 625,032 |
| New York | 543,499 | 749,795 | 229,372 | 361,520 | 1,884,187 | 5,377 | 6,546,787 | 6,552,164 |
| North Carolina | 414,439 | 2,258,954 | 116,264 | 671,972 | 3,461,629 | 2,414 | 1,101,328 | 1,103,742 |
| North Dakota | 51,171 | 224,602 | 25,501 | 26,402 | 327,676 | 1,299 | 120,515 | 121,814 |
| Ohio | 1,091,153 | 342,997 | 150,893 | 369,835 | 1,954,878 | 15,955 | 5,053,413 | 5,069,358 |
| Oklahoma | 651,866 | 696,112 | 120,537 | 337,319 | 1,815,834 | 17,706 | 641,409 | 659,115 |
| Oregon | 98,312 | 22,374 | 54,359 | 221,917 | 386,962 | 7,013 | 171,513 | 178,526 |
| Pennsylvania | 1,474,544 | 224,904 | 306,218 | 457,779 | 2,463,445 | 63,893 | 2,764,139 | 2,828,032 |
| Rhode Island | 138,917 | 147,628 | 32,271 | 76,878 | 395,694 | 1,130 | 415,354 | 417,484 |
| South Carolina | 595,656 | 1,316,068 | 168,103 | 526,418 | 2,606,245 | 22,585 | 545,581 | 568,166 |
| South Dakota | 36,369 | 145,977 | 23,540 | 40,741 | 246,627 | 1,759 | 65,667 | 67,426 |
| Tennessee | 190,774 | 201,973 | 108,973 | 397,090 | 898,374 | 30,197 | 1,088,248 | 1,118,445 |
| Texas | 1,849,868 | 3,258,588 | 319,561 | 2,036,072 | 7,264,089 | 126,464 | 9,136,350 | 9,262,814 |
| Utah | 632,384 | 135,528 | 98,639 | 108,005 | 974,556 | 13,846 | 958,799 | 982,645 |
| Vermont | 17,544 | 1,992 | 23,798 | 33,297 | 76,631 | 764 | 162,595 | 163,359 |
| Virginia | 3,479,351 | 4,154,703 | 184,847 | 1,560,075 | 9,378,976 | 37,773 | 5,858,975 | 5,896,749 |
| Washington | 879,416 | 1,293,047 | 131,083 | 725,181 | 3,028,727 | 46,395 | 2,904,660 | 2,951,055 |
| West Virginia | 48,764 | 9,694 | 33,283 | 88,868 | 180,605 | 37,775 | 125,665 | 163,440 |
| Wisconsin | 94,037 | 23,889 | 171,867 | 125,980 | 415,773 | 7,361 | 1,073,428 | 1,080,789 |
| Wyoming | 32,276 | 81,796 | 13,199 | 36,624 | 163,895 | 123 | 67,013 | 67,136 |
| Total U.S. | 27,959,767 | 38,220,511 | 5,821,458 | 20,590,933 | 92,592,669 | 1,365,357 | 118,551,260 | 119,916,607 |

Prepared by: Washington Headquarters Services Directorate for Information Operations and Reports

## APPENDIX D

## EXCERPTS FROM NEW YORK TAX LAW

### § 607. Meaning of terms

(a) General. Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute. Any reference in this article to the laws of the United States shall mean the provisions of the internal revenue code of nineteen hundred eighty-six [1] (unless a reference to the internal revenue code of nineteen hundred fifty-four is clearly intended), and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time for the taxable year.

### § 687. Limitations on credit or refund

(a) General.—Claim for credit or refund of an overpayment of income tax shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed, within two years from the time the tax was paid. If the claim is filed within the three year period, the amount of the credit or refund shall not exceed the portion of the tax paid within the three years immediately preceding the filing of the claim plus the period of any extension of time for filing the return unless such claim is for a credit or a portion thereof pursuant to subsection (e) of section six hundred six of this chapter. If the claim is not filed within the three year period, but is filed within the two year period, the amount of the credit or refund shall not

exceed the portion of the tax paid during the two years immediately preceding the filing of the claim unless such claim is for a credit or a portion thereof provided pursuant to subsection (e) of section six hundred six of this chapter. Except as otherwise provided in this section, if no claim is filed, the amount of a credit or refund shall not exceed the amount which would be allowable if a claim had been filed on the date the credit or refund is allowed.

## APPENDIX E

AMERICAN BAR ASSOCIATION

SECTION OF TAXATION

REPORT TO HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED that the American Bar Association recommends to the state legislatures and municipal governing bodies of the United States that they adopt standards for state and local tax procedures that call for: (1) identical statutes of limitations for deficiencies and refunds; (2) identical interest rates for deficiencies and refunds; (3) no automatic imposition of penalties; (4) payment of disputed taxes only after the taxpayer is provided a hearing; (5) no seizure of property until after final adjudication; (6) a period of at least ninety days between the date of the deficiency notice and the date a notice of appeal is due; (7) the elimination of state fees to cover audit expenses; (8) providing taxpayers with due process; and, (9) eliminating the need for taxpayers to relitigate identical legal issues in the same jurisdiction.

REPORT

For many years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. When taxpayers perceive such treatment, voluntary compliance is seriously threatened. Addressing these concerns should increase respect for the tax system and improve the level of voluntary compliance.

Recent years have witnessed a significant increase in the amount of taxes raised at the state and local levels. For example, for the twelve months ended March 1989, state and local governments collected $488.1 billion—a 6.3 per-

cent increase over the twelve month period that ended March 1988. Increased tax revenues have resulted from tax increases (*e.g.*, rate increases, new taxes, broadening of existing tax bases) and enhanced enforcement of existing tax laws. The enhanced enforcement of state and local tax laws has increased the number of sensitive contacts between taxpayers and revenue collection agencies. The increase in contacts has heightened taxpayers' awareness of tax collection procedures. All of this has focussed discussion on the need for state tax policy makers and legislatures to give serious consideration to the procedural rights of taxpayers.

Consideration has led to very different responses. Some states have adopted procedural reforms through legislation while some states have done so through policy pronouncements from the revenue agency within the executive branch that is charged with implementing the tax laws. Further, some states have created a taxpayer advocate office, similar to the consumer advocate offices created during the 1960s and 1970s. Other differences are the ability to record interviews with auditors and the ability to sue the states. A comparison of all the laws that have passed is beyond the scope of this Report.

In September of 1988, California became the first state to adopt a taxpayers' bill of rights. California's legislation preceded the federal taxpayers' bill of rights. Subsequent to California's adoption, Arkansas, Illinois, Indiana, Kansas, Ohio, Oregon, and South Carolina also adopted taxpayer's bill of rights through legislation. Hawaii, Maryland, New York (state and city) and Texas adopted procedural reforms through policy pronouncements.

Over the years model legislation has been recommended that addressed procedural, due process and policy considerations in the state and local tax area. In addition to these model acts endorsed by the ABA, it is appropriate

to enumerate broad principles to guide state tax policy makers and legislatures.

A review of the procedural reforms adopted by thirteen states reveals that none of the thirteen states have adopted all of the principles recommended.

Specific statutory language is not recommended because it is viewed that: (i) it is almost impossible to draft language to amend or replace existing language that is in many instances scattered throughout the statutory framework of the various states; (ii) some states have already enacted certain of the recommended principles into their statutes and would find statutory language covering additional principles difficult to use; (iii) informal discussions with officials from various states and with national tax organizations reveal that they do not think that statutory language would be desirable in this circumstance; and, (iv) it would be desirable to affect the procedural tax reform process that is currently sweeping the states in a timely fashion.

## PRINCIPLES

1. *Statutes of Limitations—Other than Fraud*

   State and local statutes of limitations for assessments, in cases other than those involving fraud, should be the same for deficiency assessments and refunds.

   Federal audit adjustments should open state and local income tax periods which are otherwise closed by statute only for those issues raised in the federal audit.

2. *Interest Rates*

   Interest rates for deficiencies and refunds should be the same. Interest is payment for the time value of money. It should not be imposed at a rate that punishes a taxpayer for failure to pay taxes timely. State and local efforts to encourage timely payment of taxes

and to punish non-compliance should be addressed by penalties and/or civil or criminal sanctions.

3. *Penalties*

There should be no automatic imposition of penalties. Reasons for proposed penalties should be provided to the taxpayer by the taxing agency. The taxpayer should be given an opportunity to appeal, and penalties should be abated upon a showing by the taxpayer of reasonable cause. Penalties should not be enacted by legislatures to raise revenue—they should be designed soley to encourage compliance.

4. *Payment After Hearing*

Taxpayers should not be required to post a bond or make a payment of a disputed tax until they have been afforded an opportunity for a hearing.

5. *Seizure of Property*

A state or municipality should only be able to seize a taxpayer's property or levy against a taxpayer's assets after a final adjudication of the disputed amount or as a result of a jeopardy assessment where the probability of payment would be substantially reduced by the passage of time.

6. *Appeal Period*

Taxpayers should not have to file a notice of appeal until at least ninety days have passed from the date on the notice of assessment. A reasonable period thereafter should be allowed for adequate preparation before a hearing is held and an opportunity should exist for the taxpayer to amend an appeal.

7. *Fees*

Taxpayers should not have to pay the state or local government a fee for its expenses in auditing the

taxpayer. Taxpayers should not have to pay the state or local government's court costs or litigation fees if a taxpayer prevails in a dispute.

8. *Due Process*

Taxpayers should be afforded both an opportunity for a hearing before an independent tribunal and receive an appealable decision therefrom. Taxpayers should also have the opportunity to be represented by counsel and afforded other standards of due process like the use of discovery.

9. *Application of Decisions*

Once the highest court in a jurisdiction rules on a particular legal issue taxpayers should not have to relitigate the identical issue in the same jurisdiction.

## COMMENTS ON PRINCIPLES

1. *Statutes of Limitation—Other than Fraud*

The underlying premise supporting civil statutes of limitation is that there is a period beyond which establishing the factual characteristics of a case becomes burdensome, difficult or impractical. This is, likewise, true with regard to issues arising under state and local tax laws.

Several states have statutes of limitation that allow the state and local government a longer period to assess a tax deficiency than the taxpayer has to claim a refund. This is perceived as creating an inequity, particularly when the taxpayer has not committed fraud.

In the area of taxation, the facts needed to establish the taxpayer's correct liability are generally reflected in the taxpayer's books and records. In many instances, taxpayers maintain books and records solely

for the purpose of being able to substantiate prior tax positions. Determining the period of time during which taxpayers should be required to maintain books and records is a subjective matter best left to the judgment of the legislature. However, once a taxpayer has been asked to maintain books and records and to continue being exposed to potential increases related to past tax periods, it seems only fair to require that the government also expose itself to the risk of having to refund taxes erroneously paid for a like period.

Because many states and local jurisdictions use federal taxable income or federal adjusted gross income as a starting point in determining state income or franchise taxes, a federal audit adjustment may trigger the need to file an amended state or local income tax return. Often, the federal audit adjustment is made after the statute of limitation has expired for auditing the state or local income tax return. When this occurs, the federal audit adjustment should not be used by the state or local government as an excuse to audit the taxpayer's state or local income tax return for issues other than those raised in a federal audit.

2. *Interest Rates*

Consistent with the treatment of interest applied to federal income tax deficiencies and refunds, some states and local governments apply a higher interest rate to deficiencies than they pay when taxes are refunded.

This appears to be an unjustifiable position if one accepts the premise that interest should be the payment for the time value of money. Interest should not be used to punish a taxpayer for the over- or underpayment of taxes—this is best done through penalties and other civil/criminal sanctions.

Some commentators have advanced the argument that higher interest rates are justified for deficiencies than for refunds because the state takes a credit risk with respect to the taxpayer's ability to pay the deficiency whereas the taxpayer presumably bears a smaller risk. Some taxpayers, however, are excellent credit risks, on a par with governmental bodies. It is inequitable to apply a higher interest rate to all taxpayers with deficiencies because a few are poor credit risks. If there is a question about a taxpayer's ability to pay a deficiency, seizure of property remedies are available. See comment on seizure of property, below.

3. *Penalties*

In recent years, the imposition of penalties has begun to be used as a revenue raising technique. Many tax jurisdictions automatically add penalty assessments to virtually all tax deficiencies. This is inappropriate if a taxpayer is neither notified of the reasons for the proposed penalties nor provided an opportunity to appeal such penalties. At a minimum, the tax agency should be required to have some basis for the penalty imposition. Further, penalties should be abated upon a showing of a reasonable cause.

4. *Payment After Hearing*

In many instances, taxpayers are required to post a bond or make payment of disputed taxes before being afforded an opportunity for an administrative appeal. This is inconsistent with federal income tax procedure and may often impose a severe hardship on taxpayers, especially when taxes erroneously collected from taxpayers are later refunded at below market interest rates.

5. *Seizure of Property*

Many state and local tax authorities abuse their power to seize property by exercising this power much too

frequently. This power should be utilized only after a final adjudication of the disputed amount or in instances where a designated governmental official determines that the probability of payment (*i.e.*, the collection for a deficiency) would be substantially reduced by the passage of time. The standards utilized to determine whether a jeopardy assessment is appropriate should be similar to those adopted by the federal government for purposes of the collection of federal taxes. Treasury Regulation 1.6851-1(1)(a) sets forth three conditions where a collection is in jeopardy: (i) the taxpayer is or appears to be "designing quickly" to leave the United States or go into hiding; (ii) the taxpayer is or appears to be "designing quickly" to place taxpayer's assets outside the reach of the government by removing, concealing, dissipating or transferring the assets; or, (iii) the taxpayer's financial solvency is or appears to be imperiled.

6. *Appeal Period*

A taxpayer's ability to appeal a tax assessment is basic to providing the taxpayer with due process. The regular delays encountered with mailing assessment notices and the amount of time necessary to evaluate such notices and determining whether an appeal is appropriate require that taxpayers be provided at least ninety days from the date on the assessment notice to file a notice of appeal. Shorter appeal periods often effectively eliminate any opportunity for due process.

As a related matter, once a notice of appeal is filed, taxpayers should be given time to amend such notice in order to perfect the appeal. Otherwise, a requirement that the taxpayer set forth his entire case may in some instances deprive taxpayers of the opportunity to analyze thoroughly the notice of assessment in conjunction with the taxpayer's books and records and other relevant information.

7. *Fees*

Some jurisdictions impose fees on taxpayers for expenses incurred in auditing the taxpayer and for legal costs incurred in defending tax appeals. While user fees may be an appropriate way of funding government services, it is unreasonable to charge taxpayers for the state's audit costs and it is also unreasonable to charge court costs if the taxpayer prevails in a dispute.

8. *Due Process*

Minimum standards of due process should be afforded a taxpayer when a tax is in dispute. Those standards include: (i) the opportunity to appeal an assessment before an independent tribunal; (ii) the opportunity to receive a decision from the independent tribunal which decision can then be appealed to a court; (iii) representation by counsel; (iv) the ability to call witnesses including government witnesses; and, (v) the availability of discovery to all parties.

It is believed that if the first level administrative appeal is provided by a part of an agency that has revenue collection responsibilities, then a de novo appeal should be provided to the taxpayer. In at least one jurisdiction (New York State) the revenue collection agency (*i.e.*, the Department of Taxation and Finance) cannot appeal unfavorable decisions from the Tax Appeals Tribunal to the courts. The concern is that this may have a chilling effect on the willingness of the tax tribunal to rule in favor of the taxpayer on the theory that the taxpayer can always appeal to the courts.

The burden of proof should generally be on the taxpayer, but, irrespective of who bears the burden of proof, the burden should ordinarily be met by a preponderance of the evidence.

9. *Application of Decisions*

State and local governments should establish procedures for implementing judicial resolutions of legal issues. Once the tax authority has lost a legal issue against a taxpayer, before the highest court in the state, there should exist some mechanism for ensuring that similarly situated taxpayers will not be faced with the litigation of legal issues that have already been resolved.

10. *Prospectivity*

There is a strong reluctance on the part of state and local governments to grant tax refunds when a tax has been held to be illegal or unconstitutional. Sometimes, there is a reluctance to refund taxes to the taxpayer litigant, and other times there is a reluctance to refund taxes to all similarly situated taxpayers unless those taxpayers have filed protective refund claims and/or lawsuits. The reluctance to grant refunds provides taxpayers with a disincentive to contest taxes and may serve to erode confidence in a voluntary system of tax compliance.

The issue of whether federal law requires state and local governments to provide taxpayers with retroactive relief when taxes have been exacted in violation of the commerce clause is before the U.S. Supreme Court in the case of *McKesson Corporation v. State of Florida* (October 1989 Term). While the tax authorities' reluctance to part with taxes that have been spent is understandable, the governments should either be prepared to refund taxes or they should escrow disputed taxes. However, no position is being taken on this issue, at this time, pending a review of the forthcoming Supreme Court decision.

Respectfully submitted,

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